Supreme Court, U. S.
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IN THE

# SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1977

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NO. 77-351

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STATE OF ALABAMA,

Petitioner

v.

ROCKAWAY CORPORATION

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PETITION FOR A WRIT OF CERTIORARI
TO THE COURT OF CIVIL APPEALS
OF THE STATE OF ALABAMA

---

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September 2, 1977

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**IN THE**
**SUPREME COURT OF THE UNITED STATES**
**October Term, 1977**

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**NO. _____**

---

**STATE OF ALABAMA,**

*Petitioner*

**v.**

**ROCKAWAY CORPORATION**

---

**PETITION FOR A WRIT OF CERTIORARI TO THE COURT OF CIVIL APPEALS OF THE STATE OF ALABAMA**

---

**The Petitioner, the State of Alabama, prays that a Writ of Certiorari issue to review the opinion and judgment of the Alabama Court of Civil Appeals and the refusal of the Alabama Supreme Court to review said opinion and judgment which refusal was entered on June 10, 1977.**

## OPINIONS BELOW

**The opinion of the trial court, the Fifteenth Judicial Circuit of Alabama, Montgomery County, is unreported and appears at Appendix A, *infra*, p. 15. The opinion of the Alabama Court of Civil Appeals is reported at 346 So.2d 444 and the order of the Alabama Supreme Court denying certiorari is reported at 346 So.2d 451. These are respectively set forth as Appendix B and C hereof, *infra* pp. 22 and 32.**

## JURISDICTION

**The final order of the highest court in the State of Alabama with jurisdiction to review this question was entered on June 10, 1977, 344 So.2d 451. This Petition for Certiorari was filed less than 90 days from the date aforesaid. The jurisdiction of this Court is invoked under 28 U.S.C. § 1257(3), as the validity of a state statute respecting lease tax has been drawn into question as being repugnant to the patent laws of the United States.**

## QUESTIONS PRESENTED

This case arose as an appeal by Rockaway from an assessment for lease tax levied under Section 629(22) of Title 51, Code of Alabama 1940, Recompiled 1958, Cumulative Pocket Part. In attacking the assessment Rockaway asserted that payments made to Rockaway which were the basis of the assessment covered the right to manufacture "rock fastener boxes" under the claims of U.S. Patents No. 1,935,030 and No. 2,154,538, as well as the right to the use of other patents described in the lease and license agreement. This contention gives rise to the following questions:

Can an expired patent be the basis for classifying payments as royalties, thereby removing such payments from the measure of the Alabama Lease Tax, when such payments would otherwise be classified as rental payments, and, as such, part of the measure of the Alabama Lease Tax?

Can a patentee, by contract, extend the effect of his patent beyond the term thereof as established by Section 154 of Title 35, U.S.C., so as to avoid a tax which otherwise would be levied?

## CONSTITUTIONAL PROVISIONS INVOLVED

Constitution of the United States, Article 1, Section 8, Clause 8:

> "The congress shall have power. . .
>
> "To promote the progress of science and useful arts, by securing for limited times to authors and inventors the exclusive right to their respective writings and discovery; . . ."

## FEDERAL STATUTE INVOLVED

This case involves Part 2, Chapter 14, Section 154 of the 1952 Patent Act, 66 Stat. 804, as amended in 1965, 79 Stat. 261, 35 U.S.C. 154, which provides:

> "Every patent shall contain a short title of the invention and a grant to the patentee, his heirs or assigns, for the term of seventeen years, subject to the payment of issue fees as provided for in this title, of the right to exclude others from making, using, or selling the invention throughout the United States, referring to the specification for the particulars thereof. A copy of the specification and drawings shall be annexed to the patent and be a part thereof."



## STATE STATUTE INVOLVED

The Alabama statute involved in this matter is Act 96 of the First Special Session of the 1971 Alabama Legislature, codified as Section 629(21) through Section 629(28) of Title 51, Code of Alabama 1940, Recompiled 1958, as amended, and appears on pp. 151-155 of the Cumulative Pocket Part. The specific provisions of that Act here involved are Sections 629(21) (d) and (e) and 629(22) which provide:

> "(d) The term 'gross proceeds' means the value proceeding or accruing from the leasing or rental of tangible personal property, without any deduction on account of the cost of the property so leased or rented, the cost of materials used, labor or service cost, interest paid or any other expense whatsoever, and without any deductions on account of loss, and shall also include on the part of any person claiming exemption under subdivision (d) of section 629 (23) of this title an amount equal to the amount of rental paid on any tangible personal property acquired under such exemption and thereafter diverted to the use of such person."
>
> "(e) The term 'leasing or rental' means and includes a transaction whereunder the person who owns, or controls the possession of, tangible personal property permits another person to have the possession or use thereof for a consideration and for the duration of a definite or indefinite period of time, without transfer of the title to such property. The detention by the user thereof of freight cars, oxygen and acetylene tanks, and similar property, in respect of which detention a demurrage or per diem charge is made against the user of such property, shall not be deemed to constitute a transaction whereunder property is leased or rented to another within the meaning of this article."
>
> "§ 629(22). Tax imposed; rates.–In addition to all other taxes now imposed by law, there is hereby levied and shall be collected as herein provided a privilege or license tax on each person engaging or continuing within this state in the business of leasing or renting tangible personal property at the rate of 4% of the gross proceeds derived by

the lessor from the lease or rental of tangible personal property; provided, that the said privilege or license tax on each person engaging or continuing within this state in the business of leasing or renting any automotive vehicle or truck trailer, semitrailer, or house trailer, shall be at the rate of 1½% of the gross proceeds derived by the lessor from the lease or rental of such automotive vehicle or truck trailer, semitrailer, or house trailer; provided further, that the tax levied in this article shall not apply to any leasing or rental, as lessor, by the state, or any municipality or county in the state, or any public corporation organized under the laws of the state, including without limiting the generality of the foregoing, any corporation organized under the provisions of Act No. 648 adopted at the 1949 regular session of the legislature of Alabama, as amended [Title 37, sections 815 to 830]; provided further, that the privilege or license tax on each person or firm engaging or continuing within this state in the business of the leasing and rental of linens and garments, shall be at the rate of 2% of the gross proceeds derived by the lessor from the lease or rental of such linens and garments."

## STATEMENT OF THE CASE

This case arose as an appeal by Rockaway Corporation (hereinafter "Rockaway") from a final assessment for taxes levied by the Alabama Lease Tax Law (Title 51, Section 629(21) through (28), Code of Alabama 1940, Recompiled 1958, Cumulative Pocket Part). The appeal was taken in the Circuit Court of Montgomery County, Alabama, in accordance with the applicable provisions of the revenue laws of Alabama. The case was tried on May 13, 1976. The trial court entered an Opinion and Judgment on the 14th of July, 1976, in which it held that the assessment was illegal and invalid and ordered the assessment set aside. From this the State of Alabama took its appeal to the Court of Civil Appeals. On April 6, 1977, the Court of Civil Appeals rendered its opinion in which it reversed the decision of the trial court and remanded the case for futher proceedings. In its opinion reversing the trial court, the Court of Civil Appeals held that payments made pursuant to clause 3(a) of paragraph 3 of the agreement, Exhibit 8 (Appendix to the State's brief before the Court of Civil Appeals following p. 91), constitute royalty payments and that receipts obtained pursuant to clause 3(b) are royalties insofar as the sale or production of boxes to which Rockaway retains the patents. The Court also held "we deem it immaterial that these patents have now expired. . ." The Court held that receipts obtained by Rockaway pursuant to clauses 3(a) and 3(b) based on gross receipts from a sale or production of boxes to which Rockaway retains the patents are not subject to the tax imposed by Title 51, Section 629(21) et seq., Code of Alabama 1940, Recompiled 1958, Cumulative Pocket Part. The State applied for rehearing respecting the above enumerated holdings and errors and on May 11, 1977, the Court of Civil Appeals extended its opinion and denied the application for rehearing. In its extended opinion the Court stated:

> "This court's opinion is in large measure bottomed on the interpretation of the contract between Miller and Rockaway. The fact that one of the parties may not have to abide by the terms of the contract does not give the State the authority to take advantage of this fact and levy a tax.
>
> "This court would further note that since the rendition of our original decree, we have discovered the case of **Stone v. Stapling Machines Co.**, 71 So.2d 205 (Miss. 1954). This case involves the exact situation that was before us in our original opinion. Although a somewhat different conclusion was reached, the same rationale employed by this court was used by the Supreme Court of Mississippi in **Stone,** *supra.*
>
> "In **Stone,** *supra,* the Mississippi Supreme Court defined 'royalty' as a tax or duty paid to the owner of the patent for the privilege of manufacturing or using the patented article. We perceive no reason why the fact that a party may not be obligated to make such payment allows the State to collect a tax pursuant to the lease tax statute."

Rockaway is a Delaware corporation in the business of manufacturing and leasing of large machines (R. p. 4) specifically adapted and designed for making wirebound boxes. (R. pp. 5, 6 and 34) These machines are never sold but are leased (R. pp. 63, 66, 67) to some 35 or 40 box manufacturers in 23 states and 11 foreign countries. (R. pp. 37-38) T. R. Miller Mill Company is the only such manufacturer in the State of Alabama. (R. pp. 37-38)

The evidence is clear, and uncontested, that Rockaway and Miller entered into a lease agreement whereby Miller has the use of Rockaway's machines in its business. (R. p. 38) The lease docu-

ment is unambiguous and therefore does not require oral testimony to explain its provisions. It is designated as Exhibit 8. (R. p. 36,40) It is the only arrangement or agreement between Rockaway and its Alabama customer, T. R. Miller Mill Company. (R. p. 67) On its face, the document is a lease whereby Rockaway is the lessor and Miller is the lessee of the machinery. The pertinent provisions of the lease appear in paragraph 3 as follows:

> "3. Lessee agrees to pay to Lessor, in addition to the amounts hereinbefore provided to be paid by Lessee for the initial right to possess the machines leased hereunder, (a) sums of money equal to four per cent (4%) of the gross sales or fair market value, whichever is higher, of all 'Rock Fastner', 'All-Bound', and 'James' boxes made under this agreement, and (b) sums of money equal to two per cent (2%) of the gross sales or fair market value, whichever is higher, of all other boxes made under this agreement; and Lessee agrees to pay such sums as a royalty for the use of any or all of the patented inventions hereinunder licensed to be used **and/or** as a rental for the use of any or all machines leased hereunder; and Lessee agrees to pay such sums . . . on or before the fifteenth day of each calendar month . . ." (Emphasis supplied)

David G. Kingsley, Senior Vice President of Rockaway Corporation, testifying for Rockaway, (R. pp. 34-68) discussed his understanding of the payment arrangement required by the agreement. (R. pp. 40, 41) Essentially payments are made to Rockaway in two forms. First, an initial right to possess fee which was paid by Miller to Rockaway many years ago and second a rental or lease payment which Mr. Kingsley termed a royalty at either two or four per cent of the proceeds derived by Miller from the sale of boxes made by Miller with the use of Rockaway's machines. On cross-examination Mr. Kingsley admitted that the patents on the machines themselves have expired (R. p. 66) and that the agreement does not purport to require royalty payments based upon patents. (R. p. 65) Mr. Kingsley testified that Rockaway Corporation owns the machines and never sells them. (R. p. 63) Mr. Kingsley testified that there was no other agreement between Rockaway and its customers except that agreement embodied in the lease. (R. p. 67)

Because of the incorrect decision of the Court of Civil Appeals on a matter of first impression in the appellate courts of Alabama, the State of Alabama petitioned the Alabama Supreme Court



for a Writ of Certiorari to review the decision of the Court of Civil Appeals. On June 10, 1977, the Alabama Supreme Court refused to grant the Writ. In view of the importance of the decision of the Court of Civil Appeals and the interpretation of the patent laws of the United States set forth in the opinion of the Court of Civil Appeals, the State of Alabama petitions the United States Supreme Court to grant its writ and review the decision.

## HOW THE FEDERAL QUESTION WAS RAISED

Paragraph 10 of the Bill of Complaint by which the assessment was appealed, reads as follows:

> "The total payments made to Rockaway by Miller which are the basis of the assessment in this cause are not totally payments for the leasing or rental of tangible personal property in Alabama. Such payments by Miller also include and cover the right to manufacture 'rock fastner boxes' under the claims of United States Patents #1,933,030 and #2,154,538 as well as the right to the use of other Patents described in the Lease and License Agreement between Rockaway and Miller."

In response to that allegation, the State, in its Answer, Paragraph 8, stated:

> "For answer to Paragraph 10 of said Bill of Complaint, Defendant-Appellee denies each and every allegation made therein. Further in answer to Paragraph 10, Defendant-Appellee alleges and shows unto this Court that patents numbered 1,933,030 and 2,154,538 are no longer in force and therefore are not subject to license payments, the invention covered by said patents being now in the public domain."

Thus, the federal question involved in this matter was raised at the earliest possible stage in the proceedings. The trial court did not pass upon this question, but decided the case upon other grounds. On appeal to the Alabama Court of Civil Appeals, the trial court was reversed, but the Court of Civil Appeals addressed the question of the effect of the old patents.

## REASONS FOR GRANTING THE WRIT

The patent laws of the United States prohibit the patentee from

obtaining by contract any benefits by way of royalties on expired or invalid patents; any attempted reservation or continuation in the patentee of his monopoly after expiration of the patent, whatever the legal device employed, runs counter to the policy and purposes of the United States patent laws and the constitutional provision under which they are enacted. In spite of this the Alabama Court of Civil Appeals, supported by the Alabama Supreme Court's refusal to review its decision has extended at least a portion of the patentee's monopoly in the opinion which this Petitioner seeks now to have the United States Supreme Court review.

The Alabama Court of Civil Appeals had before it the issue of whether or not the cost of certain services allegedly rendered by Rockaway to its lessee, Miller, could be deducted from the measure of the lease tax levied by Section 629(21) et seq. of Title 51, Code of Alabama 1940, Recompiled 1958, Cumulative Pocket Part. On this issue the holding of the Court of Civil Appeals is eminently correct and is fully supported by the case of **Stone v. Stapling Machines Co.**, 71 So.2d 205 (Miss. 1954) which is cited in the Court of Civil Appeals decision as extended on rehearing. However, the Court of Civil Appeals saw fit to sever from the measure of the lease tax certain portions of the payments made by Rockaway's lessee saying, in so doing, that these certain portions are "royalty" payments, and as such are not subject to Alabama's lease tax. The facts do not support this finding and the Court of Civil Appeals has clearly misapplied the law to the facts.

The basic agreement between Rockaway and Miller is a lease. Throughout the agreement Rockaway is referred to as the lessor and Miller is referred to as the lessee. Paragraph 3 of the agreement, upon which the Court of Civil Appeals based its opinion is the paragraph in which the consideration for the lease is set forth. The key clause in this paragraph is ". . . **Lessee** agrees to pay such sums as a **royalty** for the use on any or all of the patented inventions hereunder licensed to be used **and/or** as a **rental** for the use of any or all machines, leased hereunder; . . ." (Emphasis supplied)

Substance, not form, must govern the determination of tax matters. **Rust Engineering Co. v. State**, 286 Ala. 589, 243 So.2d 95, at page 700, and the cases cited therein. The substance of the agreement before the Court is that of a lease. The agreement interpreted as a patent license is unenforceable by Rockaway against its lessee, Miller, at this time, and at all times covered by the assessment. However, Miller is obligated to pay Rockaway the designated percentages under the agreement interpreted as a lease. The royalty clauses in the agreement are mere form. Interpreted as



requiring royalties based upon expired patents, such clauses are unlawful per se.

If Miller did not pay Rockaway under the terms of the agreement, then Rockaway could not sue Miller upon the royalty interpretation of the agreement for such an interpretation is clearly unsupportable. However, Rockaway could successfully sue Miller upon the agreement interpreted as a lease, because the patents in question have long since expired. Stated another way, because the patents no longer exist they cannot support an agreement to pay royalties, however, Miller is obligated to pay Rockaway the sums stated as rental pursuant to the alternative provided in the agreement.[1]

It should be observed that the cases cited hereinafter with respect to royalties and the expiration of patents are primarily cases between the patent holder and his licensee. It is in this context that such cases usually arise. These cases are, however, authority for the basic proposition that an expired patent will not support an agreement to pay royalties.

Patent laws prohibit one from obtaining by contract any benefits by way of royalties on expired or invalid patents. **Bull v. Logetronics, Inc.**, 323 F. Supp. 115 at page 129.

While it is true that a single license may cover more than one patent and that the royalty under that license may remain the same until the expiration of the last patent so licensed, (**Hensley Equipment Co., Inc. v. Esco Corp.**, Fifth Circuit Court of Appeals, 155 U.S.P.Q. 183) such a license is construed to grant a plurality of licenses, one under each patent with the proviso that when any patent expires the license under that patent automatically expires. **Compton v. Metal Products, Inc.**, Fourth Circuit Court of Appeals, 453 F.2d 38, Cert.Den. 92 S.Ct. 2412, 406 U.S. 968, 31 L.Ed.2d 667. However, in the case of **American Securit Co. v. Shatterproof Glass Corp.**, 268 F.2d 769, Cert.Den. 361 U.S. 902, 4 L.Ed. 2d 157, 80 S.Ct. 210, Rehearing Denied 361 U.S. 973, 4 L.Ed.2d 553, 80 S.Ct. 584, the United States Court of Appeals, Third Circuit, held:

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[1] A discussion of the expression "and/or" may be found in Vol. 17-A, Corpus Juris Secundum, p. 165. This expression means "either and or or." Its interpretation depends upon the circumstances and it must be construed to express the intention of the parties to the contract.

"We conclude also, and quite apart from all of the foregoing, that Paragraph 8(a) of Securit's Standard Licensing Agreement which provides that that agreement shall continue 'in full force and effect to the expiration of the last to expire of any' of Securit's patents set out in 'Schedule A' **constitutes a patent misuse for it extends the payment of royalties of patents under patents which may expire** to the expiration date of that patent most recently granted to Securit. Indeed the expiration clause of the contract works an 'aggravating hardship' on the licensee as Judge Leahy stated, in that it demands the renunciation of all patents, whether wanted or unwanted under the license." (Emphasis supplied)

Exhibit A to Plaintiff's Exhibit 8 (which may be found following page 91 of the Appendix to the State's brief before the Alabama Court of Civil Appeals) is a list of United States patents owned by Rockaway (or Rockaway's predecessor) which are licensed in the lease agreement. The most recent of these patents was number 2,405,463, issued August 6, 1946. Since patents are granted for a term of 17 years (Title 35, Section 154, United States Code), this patent expired on August 6, 1963. The doctrine of patent misuse prohibits extension of the patent b[illegible] the scope of the monopoly granted by the government. **Mutchiuk v. M. S. Willett, Inc.**, (Md. Court of Appeals), 86 U.S.P.Q. 427. A claim which requires the payment of royalties beyond the expiration date of the patent constitutes misuse of the patent and is unlawful. **Petersen v. Fee International Ltd.**, (D. C. W.Okla.) 182 U.S.P.Q. 264. It has long been held and is a fundamental premise of patent law that the requirement of a payment of royalty beyond the term of the patent is, per se, misuse of the patent. There is a prohibition against continuing the patent monopoly beyond the life of the patent and this prohibition extends to royalty payments. The general rule is that any attempted reservation or continuation in the patentee of the patent monopoly after the patent expires, **whatever the legal device employed,** runs counter to the policy and purpose of the patent laws. **Brulotte v. Thys**, 379 U.S. 29, 13 L.Ed.2d 99, 85 S.Ct. 176; **Scott Paper Co. v. Marcalus Mfg. Co., Inc.**, 66 S.Ct. 101, 326 U.S. 249, 90 L.Ed. 47, Rehearing Denied 66 S.Ct. 263.

In 1970 the United States Court of Appeals, Fifth Circuit, Judge Phillips writing, observed in the case of **Pipkin v. FMC Corporation**, 427 F.2d 353, at page 357:



"Absent a clear expression to the contrary in the licensing agreement for the use of the invention embodied in a patent, it will be presumed that the parties did not intend the licensee should pay royalties for such use after the expiration of the patent.' **The License Agreement not only contained no expression manifesting that the parties intended that FMC should pay royalties for the use of the invention embodied in any one of the patents here involved,** after it had expired, but by its provisions affirmatively manifested that they did not so intend.

"Moreover, in **Brulotte v. Thys Co.**, 379 U.S. 29, 32, 85 S.Ct. 176, 179, 13 L.Ed.2d 99, the court held **'that a patentee's use of a royalty agreement that projects beyond the expiration date of the patent is unlawful per se,'** and we should avoid a construction of the License Agreement that would render it invalid." (Emphasis supplied, footnote omitted)

In view of the foregoing authorities and contrary to the Court of Civil Appeals' opinion, the fact that the patents have expired is very material with regard to whether or not Rockaway can require Miller to pay a royalty. There is no question Rockaway can require Miller to pay a rental fee in which is merged a royalty for so long as a valid, outstanding, current patent is held by Rockaway which was the subject of the license agreement. But upon expiration of the patent the merged royalty must cease to exist as a royalty based upon a patent license and necessarily becomes a mere rental which is clearly subject to the lease tax imposed by Title 51, Section 629(21) et seq., *supra.*

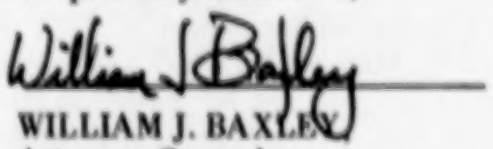
The **Stone v. Stapling Machine Co.** case, *supra*, cited in the extension of the Court of Civil Appeals opinion, was decided in 1954. Stapling Machines Co. was a predecessor to Rockaway Corporation and the agreement in the **Stone v. Stapling Machine co.** case and the agreement here under consideration were the same. (Exhibit 8, *supra*) the three boxes described are covered by or embody in their construction the subject matter of the claims in patents No. 1,933,030 and 2,154,538 ("Rock Fastner" boxes); 1,942,970 and 1,956,970 ("All-Bound" boxes); and 1,951,601, 1,951,602 and 2,022,980 ("James" boxes). The most recent of those named patents is 2,154,538 which issued on April 18, 1939 (Exhibit A, p. 10 to Plaintiff's Exhibit 8), and **expired on April 18, 1956.** The newest patent set forth in Exhibit A to Plaintiff's Exhibit 8 **expired in 1963.** Accordingly, there is presently

no valid, outstanding, current, unexpired patent upon which a license requiring royalty can be based. At the time the **Stone** case was decided in Mississippi, there were valid outstanding patents upon which the royalty could be based. Accordingly, the decision with reference to the Mississippi law in the **Stone** case reflected the facts as they existed in 1954. From the record before the Alabama Court of Civil Appeals there are presently no current, valid, patents. The patents referred to in the agreement have all expired. In paragraph 13 of the agreement is this statement: "Lessee admits the validity **for the full terms** expressed in the grants thereof of all the patents included in this agreement." (Emphasis supplied) Mr. Kingsley, Senior Vice President of Rockaway, testified that the agreement does not purport to require royalty payments based upon expired patents. Thus, it is clear that (1) there are no patents upon which a royalty could be based, and (2) Rockaway did not intend to require royalties based upon the expired patents.

## CONCLUSION

Based on the foregoing discussion of the authorities and the facts, the State of Alabama respectfully requests that the United States Supreme Court issue its Writ of Certiorari directed to the Alabama Court of Civil Appeals, and that upon a review of the record the State prays that this Court will direct the Alabama courts to hold that an expired patent cannot be the basis for classifying payments as royalties and that a patentee cannot by contract extend the effect of his patent beyond the term thereof as established by Section 154 of Title 35, United States Code, so as to avoid a tax which would otherwise attach.

Respectfully submitted,



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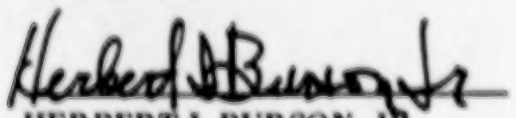

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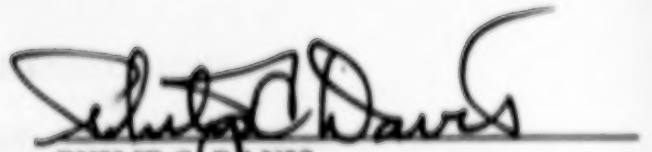
Counsel, Department of Revenue,
and Assistant Attorney General
State of Alabama





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COUNSEL FOR PETITIONER

## PROOF OF SERVICE

I, Philip C. Davis, of counsel for Petitioner and a member of the Bar of the Supreme Court of the United States, certify that I have served a copy of the foregoing Petition for Writ of Certiorai on Honorable Oakley Melton, Jr., P. O. Box 1267, Montgomery, Alabama 36102, Counsel for Respondent Rockaway Corporation, by placing same in the United States mail, postage prepaid, on September second, 1977.

PHILIP C. DAVIS
Of Counsel for Petitioner



## APPENDIX A

| | | |
|---|---|---|
| ROCKAWAY CORPORATION, | ) | IN THE CIRCUIT COURT OF |
| Plaintiff-Appellant, | ) | MONTGOMERY COUNTY, |
| vs. | ) | ALABAMA |
| STATE OF ALABAMA, | ) | CIVIL ACTION NO. 38922 |
| Defendant-Appellee. | ) | |

### OPINION AND JUDGMENT

This case is an appeal under the provisions of Title 51, § 140, Code of Alabama, from a final assessment of lease tax by the Alabama Department of Revenue against Rockaway Corporation (hereinafter Rockaway). The case was heard by the Court and submitted on the oral testimony of the witnesses and numerous exhibits and documentary evidence and the written briefs of both parties. The Court having heard and considered the testimony of the witnesses ore tenus and having considered the exhibits and the arguments and written briefs of counsel for both parties, now makes the following findings of fact, conclusions of law, and judgment.

The lease tax law was enacted by the legislature in the First Special Session of 1971 as Act No. 96 and it is now codified in Title 51, § 629(21) et seq. of the Alabama Code. The statute provides in pertinent part as follows:

> "There is hereby levied and shall be collected as herein provided a privilege or license tax on each person engaging or continuing within this state in the business of leasing or renting tangible personal property at the rate of 4% of the gross proceeds derived by the lessor from the lease or rental of tangible personal property."

By the express language of the statute the tax is levied and imposed only on the "gross proceeds derived by the lessor from the lease or rental of tangible personal property." There is no tax levied under this statute on the gross proceeds derived or received for services rendered by a person, firm or corporation.

This Court must now interpret the facts of this case to the provisions of the tax law to determine if the assessment here involved

is valid or invalid. The facts in this case are relatively undisputed and are derived from the oral testimony of Rockaway's witnesses David E. Kingsley, John Kornmeyer, and John Richard Miller and the documentary evidence offered in support of their oral testimony. The State of Alabama did not offer any oral or documentary evidence other than its formal assessment papers.

## FINDINGS OF FACT

Rockaway is a Delaware corporation, having its principal place of business and factory in Rockaway, New Jersey. Rockaway manufactures large machinery for use by box manufacturers in making wirebound boxes. There are 40 box manufacturers in 23 states in the United States and 11 foreign countries who use Rockaway box-making machines. The only such box manufacturer in the State of Alabama is the T. R. Miller Mill Company (hereinafter Miller) located in Brewton, Alabama.

The present business arrangement between Miller and Rockaway and its predecessor companies began prior to 1931. Miller and Rockaway and Rockaway's predecessor companies have, therefore, been doing business together for over 45 years. The business arrangement between Rockaway and its box manufacturers (including Miller) is unique in the business world. On December 31, 1946, Rockaway (formerly known as Stapling Machines Company) and Miller entered into an agreement which is entitled "Lease and License Agreement." This agreement was renewed for an additional 25 years by a letter agreement dated July 15, 1970. Although the agreement is entitled a "Lease and License Agreement", the Court does not feel bound or controlled in this case by the wording or form of the agreement. The Court strongly believes and finds that in cases of this type that substance must control the determination of the issues rather than mere form. The written agreement does not break down, specify, or allocate the basis for payments made under the agreement by Miller to Rockaway and in order to properly decide this case the Court must determine the true facts and actual relationship between Miller and Rockaway and the factual and legal basis of the payments made by Miller to Rockaway. In other words, this Court must determine the current status of the relationship between Rockaway and Miller and the current basis of the payments made as opposed to the mere form which was used in the old 30-year old agreement. It is absolutely necessary for substance to control over form in tax cases such as the case at bar; otherwise, the Court would open the door for in-



genuous agreements, contracts, and written documents of sundry parties to bind the Court regardless of the true facts and parties could thereby circumvent the lease tax law and other taxing statutes in Alabama. Such a course of action would permit unscrupulous parties to circumvent the tax laws of Alabama with spurious written agreements. The Court cannot, therefore, become subservient to form over substance.

In this case the Court finds that Miller makes to Rockaway two distinct kinds of payments. First, Miller makes a payment to Rockaway for the right of Miller to possess and use the box-making machine. This is a lump sum payment made at the time the machine is delivered to Miller and is in the amount of the "reasonable cost of production" of the machine. Therefore, when Miller acquires possession of a machine, Miller pays Rockaway the cost of manufacturing the machine and this cost usually runs in the neighborhood of $70,000 to $80,000. The Court finds that such payments are "gross proceeds derived by Rockaway for the lease or rental of the machine" within the meaning of the Alabama Lease Tax Law. This finding is buttressed by the fact that legal title to the machine remains in Rockaway at all times and such finding is made by the Court although the Court realizes that it will impose a rather substantial tax burden on the taxpayer and that such tax burden was not anticipated when Rockaway and Miller entered into their business arrangement; however, this is a tax burden which was created by the legislature and this Court is bound to interpret the Alabama lease tax law as enacted by the legislature.

After Miller makes the foregoing described payment to Rockaway for the right to possess and use the box-making machine, then Miller and Rockaway engage in a business relationship which is in many respects akin to a joint venture. Miller and Rockaway render mutual services for and to each other in connection with the design, development, promotion, testing, advertising, inspecting, and sale of the wirebound boxes which are made by Miller on the machinery manufactured by Rockaway. When the wirebound boxes are sold by Miller, then Miller pays Rockaway a sum equal to 2% or 4% of the gross sales of the wirebound boxes. The level of such percentage payments depends upon the specific type of box manufactured on the Rockaway machine. Such payments are contingent on sales of the wirebound boxes by Miller and are for the numerous services performed by Rockaway in connection with the design, development, promotion, testing, advertising, inspecting, and sale of the wirebound boxes. Such payments are not for

the lease or rental of the machines. In fact, the President of Miller, John Richard Miller, testified that such services by Rockaway were the reason and basis for Miller's monthly payments to Rockaway. He further testified that there would be no way Miller could or would pay Rockaway such payments for the mere physical possession or use of the machinery alone. Based on such evidence the Court finds that Rockaway's basic business is not that of renting machinery but is the business of supplying services in connection with the sale of the wirebound wooden boxes.

Rockaway performs a vital and essential role in the successful business relationship with Miller and in the sale of the wirebound boxes. Some of Rockaway's services include the following:

Box design, development and promotion.

Box testing.

Conducting training courses and seminars for Miller's box salesmen and plant mechanics.

Advertising and promotional brochures for use in the trade.

Preparation and distribution of movie films describing use and benefits of wirebound boxes.

Costing systems and cost reduction consultants and assistance for Miller and other box manufacturers.

Machinery service assistance for Miller and other box manufacturers.

Maintenance of engineering records on the machines and equipment for Miller and other box manufacturers.

Market and box arrival inspection and servicing.

Absorption of engineering and development costs for development of special machinery and equipment to make special wirebound boxes.

Development of substitute box materials and material treatment and handling methods.

Absorption of engineering and development costs for the development of box assembly and box closing machines sold to box users.

Absorption of the cost of maintenance assistance supplied to purchasers of box assembly and box closing machines.

The rendition of the foregoing described services by Rockaway distinguishes Rockaway's relationship with Miller from that of a



lessor-lessee relationship.

In addition, the payments by Miller to Rockaway are purely contingent payments and are either 2% or 4% of the gross proceeds from the sale of boxes by Miller. If there are no such sales, there are no payments by Miller to Rockaway. This arrangement is similar to the old Chinese laundry joke of "No ticky - no laundry", and is further evidence of the fact that here we have a joint undertaking by both Rockaway and Miller in the design, manufacture, promotion and sale of wirebound boxes. The monthly payments from Miller to Rockaway are not for the rental of the machinery but are for the numerous services rendered and performed by Rockaway which services directly contribute to the ultimate sale of the wirebound boxes made by Miller on the Rockaway machines.

The Alabama lease tax is not imposed on contingent payments for services rendered and the Court finds that the monthly payments made by Miller to Rockaway are contingent payments for services rendered by Rockaway. Any other interpretation of such payments would be unrealistic and would disregard the fact that the mere use of the naked machinery alone by Miller has no reasonable relationship to the amount or basis of the monthly payments made by Miller to Rockaway. The parties do not call their relationship a joint adventure or a joint undertaking but in many respects it is similar to a joint adventure since both Miller and Rockaway contribute substantial resources and services to make the ultimate sale of the wirebound boxes and both Miller and Rockaway stand to gain or lose based on the consummation or lack of such sales. Their relationship is a joint undertaking and is totally distinguishable from the usual lessor-lessee relationship where the lessor does nothing more than merely furnish property to a lessee for use by the lessee.

In reaching a decision in this case, the Court has considered the possibility of prorating the payments based on the cost accounting testimony of the certified public accountant, John Kornmeyer, and the Court has also considered Rockaway's contention that federal constitutional requirements designed to prevent excessive State taxation of the activities of a multi-state corporation mandate that Alabama use an apportionment formula with respect to its taxation of Rockaway's gross receipts in Alabama. In this connection, Rockaway contends that the application of the 4% Alabama lease tax on all of the payments made to Rockaway by Miller would really amount to a gross receipts tax on the total business of Rockaway and Miller and that such payments must be

apportioned as between Alabama and states other than Alabama since such gross receipts are generated not simply by activities of Rockaway within the State of Alabama but also by activities taking place in many other states of the United States and, particularly, in New Jersey.

Although there is considerable merit to both contentions, the Court does not find it necessary to pass on such contentions and issues in view of its announced findings herein.

The Court does not hold that the monthly payments from Miller to Rockaway are non-taxable under the lease tax law because of the constitutional principles which prevent excessive State taxation of the activities of a multi-state corporation by requiring the use of an apportionment formula with respect to a State's taxation of Rockaway's gross receipts because the Court does not believe it is necessary to pass on this contention of Rockaway in this case. Instead, the Court will follow the oft-stated rule that the constitutionality of a statute will not be determined when the cause in which its determination is sought may be finally disposed of on other issues and without such an unconstitutional determination.

## CONCLUSIONS OF LAW

Based on the foregoing findings, the Court concludes that Rockaway is liable for Alabama lease tax on the initial payment made by Miller to Rockaway for the right to possess and use a machine which payment is made when the machine is originally delivered to Miller. The Court further concludes that Rockaway is not liable for Alabama lease tax on the contingent monthly payments made by Miller for services rendered by Rockaway subsequent to the delivery of a machine. Since there were no payments for the right to possess machines included in the assessment period involved in this case (July 1, 1971 through March 31, 1973), the assessment herein is due to be set aside and vacated.

In accordance with the foregoing findings and conclusions of law, it is the

ORDER, JUDGMENT AND DECREE of the Court that the lease tax assessments herein made against Rockaway by the Alabama Department of Revenue are illegal and invalid and are hereby set aside, vacated and declared null and void.

It is further ORDERED that the costs in this case be taxed against the Defendant-Appellee State of Alabama, for which let



execution issue.

DONE this the 14 day of July, 1976.

/S/ Frank Embry, Jr.
Circuit Judge

FILED IN OFFICE
14 day of
July 1976
GEO. H. JONES, JR., Register

## APPENDIX B

STATE of Alabama

v.

ROCKAWAY CORPORATION

Civ. 954.

Court of Civil Appeals of Alabama.

April 6, 1977.

Rehearing Denied May 11, 1977.

HOLMES, Judge.

This is an appeal by the State of Alabama from a decree of the Circuit Court of Montgomery County. That court held certain proceeds paid to the taxpayer, Rockaway Corporation, were not subject to Alabama's lease tax imposed by Tit. 51, § 629(21), et seq. The pertinent part of the statute levies a tax on proceeds "accruing from the leasing or rental of tangible personal property."

The issue on appeal is whether the proceeds in question were paid to the taxpayer for the rental or lease of tangible personal property within the meaning of the statute.

The taxpayer contends that the proceeds paid to it are for personal services and, hence, not taxable. The State on appeal argues otherwise.

Tit. 51, § 629(22), Code of Alabama (1973 Cum. Pocket Part), in pertinent part provides:

> "[T]here is hereby levied . . . a privilege or license tax on each person engaging or continuing within this state in the business of leasing or renting tangible personal property at the rate of 4% of the gross proceeds derived by the lessor from the lease or rental of tangible personal property; . . ."

The term "gross proceeds" is defined as:

> ". . . the value proceeding or accruing from the leasing or rental of tangible personal property, without any deduction on account of the cost of the property so leased or rented, the cost of materials used, labor or service cost, interest paid or any other expense whatsoever, . . ." (Tit. 51, § 629(21)(d), Alabama Code (1973 Cum. Pocket Part))



Pursuant to the above statute, the State made a final assessment of taxes against the taxpayer-Rockaway. Taxpayer appealed this assessment to the Circuit Court of Montgomery County, where trial was had on May 13, 1976.

The evidence adduced at the trial is virtually undisputed and reveals the following:

Taxpayer-Rockaway, operating under various names, has been engaged in the development of wirebound boxes and wirebound box machinery continuously since 1907. The primary machinery which it manufactures is utilized in producing wirebound boxes. Taxpayer leases this machinery to numerous manufacturers located both throughout the continental United States and in twelve foreign countries.

The T. R. Miller Mill Company, Inc., of Brewton, Alabama, is the only company with whom the taxpayer has business dealings in the State of Alabama.

On December 31, 1946, taxpayer and the Miller Company entered into a 25-year "Lease and License Agreement," which was renewed through exercise of an option by the Miller Company in 1970. Taxpayer is referred to as "Lessor" in the agreement; the Miller Company is termed the "Lessee." Pertinent portions of this agreement are as follows:

> "Lessor is willing to lease box-making machines to Lessee and to license Lessee under said patents on the terms and under the conditions hereinafter set forth.
>
> . . . . . .
>
> "1. . . . Lessor hereby gives to Lessee the right and license (a) to make on Lessor's machines in the factory of Lessee at Brewton, Alabama boxes covered by any one or more of the patents listed in Exhibit A; (b) to use in said factory, for the manufacture of boxes, machines leased hereunder from Lessor; (c) to use in said factory, for the manufacture of boxes on Lessor's machines, the method inventions covered by any one or more of said patents; and (d) to sell in the United States boxes made under this agreement.
>
> . . . . . .
>
> "2. Subject to the terms and conditions herein contained, Lessor hereby leases to Lessee the machines of Lessor now or

hereafter delivered to Lessee for use hereunder.

. . . . . .

"Lessee hereby agrees to pay to Lessor *for the initial right to possess all machines leased hereunder,* delivered F.O.B. place of manufacture, a sum of money, to be specified by Lessor, not to exceed the reasonable cost of production of such machines, . . .

"Lessee agrees that it shall not have or assert any property right in any machine leased under this agreement, but shall have only the right to use the same under the conditions of this agreement.

. . . . . .

"3. Lessee agrees to pay to Lessor, *in addition to the amounts hereinbefore provided to be paid by Lessee for the initial right to possess the machines leased hereunder, (a) sums of money equal to four per cent (4%) of the gross sales or fair market value, whichever is higher, of all 'Rock Fastener', 'All-Bound', and 'James' boxes made under this agreement, and (b) sums of money equal to two per cent (2%) of the gross sales or fair market value, whichever is higher, of all other boxes made under this agreement;* and Lessee agrees to pay such sums as a royalty for the use of any or all of the patented inventions hereunder licensed to be used and/or as a rental for the use of any or all machines leased hereunder; and Lessee agrees to pay such sums . . . on or before the fifteenth day of each calendar month, . . ." [Emphasis supplied.]

In accordance with paragraph 2 of the agreement, the Miller Company paid Rockaway a $112,500 fee for the initial right to possess the machinery. The factory cost to Rockaway for the machinery it provided to the Miller Company was $176,225. Payments pursuant to clause 3 above for the "use of the patented inventions . . . and/or as a rental for the use of any or all machines leased" have totaled in excess of $3,000,000 over the years.

David G. Kingsley, a senior vice president of Rockaway, testified that the "patented inventions" referred to in the above quoted portion of paragraph 3 related to patents on boxes. On cross examination, he admitted that patents had expired for three of the boxes on which Rockaway was receiving a 4% "royalty" payment.

Kingsley also testified that in addition to providing the Miller Company with machinery, Rockaway provided numerous additional services to that company and all of Rockaway's lessees. There were no charges to the Miller Company or any other lessees, other



than the two set forth above, for these additional services, which are extensive.

Rockaway develops and designs wirebound boxes. The wirebound box industry differs from other manufacturing industries in that the boxes are not merely manufactured, placed on shelves, and sold. Rather, boxes usually must be integrated into an already existing user packaging procedure. Rockaway deals directly with these ultimate users, i. e., the customers who purchase boxes from Rockaway's lessees, to determine their requirements for boxes. In this manner, Rockaway both creates a demand for its patented boxes, which are sold by its lessees, and also insures that its leased machinery possesses the capacity to produce boxes of the desired chacteristics.

Taxpayer-Rockaway advertises and prints promotional brochures regarding the boxes for its lessees. Rockaway also operates two laboratories for testing the strength and durability of boxes. The taxpayer additionally conducts "market and box arrival inspections and servicing" whereby it maintains employees in major terminals to check the condition of its lessees' boxes upon arrival at a receiver's warehouse.

Taxpayer-Rockaway also provides the following services to its lessees without charge: training courses for box salesmen and plant mechanics; cost systems and cost reduction consultation; and machinery service assistance. Furthermore, Rockaway maintains engineer records regarding the equipment held by each lessee, so that it can respond to inquiries from the various lessee-manufacturers concerning the type boxes their machinery is capable of manufacturing.

Other services relating to the development of machinery and substitute box materials are also provided by Rockaway without cost.

Kingsley, the Rockaway vice president, further testified that Rockaway retained the same agreement with all of its lessees, the pertinent provisions of which have been set forth, *supra.*

John R. Miller, the president of the T. R. Miller Mill Company, Inc., testified that his company purchases machines and equipment from numerous other companies, none of which provided the type services rendered his company by Rockaway. He stated the Miller Company could not afford to pay the sum of money it did to Rockaway if the latter did not provide the above enumerated services.

Against this background, the trial court found that the lump sum payment of $112,500, made by the Miller Company to taxpayer-Rockaway for the "initial right to possess" the machinery, was for the lease or rental of tangible personal property and therefore subject to the lease or rental tax imposed by Tit. 51, § 629(22), Code of Alabama.

The $3,000,000 in monthly payments from the Miller Company to Rockaway, the amount of which was determined by the lessee's gross receipts derived from the sales of its boxes (pursuant to paragraph 3 of the agreement), were held to have been made for services rendered and therefore not subject to the lease or rental tax levied by Tit. 51, § 629(22). It is from this latter finding that the State has taken this appeal.

As previously noted, the State contends the decree of the trial court is clearly erroneous insofar as it fails to tax the variable monthly sums paid by the Miller Company to Rockaway pursuant to paragraph 3 of their agreement. The State argues that the only agreement between Rockaway and the Miller Company is that embodied in the written contract, the substance of which is a lease.

Taxpayer, on the other hand, contends in accordance with the findings of the trial court, that the variable payments, 4% or 2% of the gross sales made by the Miller Company, depending upon the type box involved, are actually for services rendered. Consequently, taxpayer concludes, since the payments are for services rendered, they are not governed by Tit. 51, § 629(22), which only imposes taxes on gross receipts derived from leases or rentals. As shown below, this court is not in absolute agreement with either party.

In order for the variable monthly payments made by the Miller Company to taxpayer-Rockaway to be subject to the tax levied by Tit. 51, § 629(21), et seq., it is mandatory that they have been made for the lease or rental of business machines. To determine whether the payments were so made, it is necessary to ascertain the true nature of the agreement between the parties. Put another way, the intent of the parties to the agreement must be established. Substance must govern over form. Otherwise, evasion of the taxing statutes would be permitted by merely affixing a nontaxable label to an otherwise taxable transaction. *Boswell v. Paramount Television Sales, Inc.*, 291 Ala. 490, 282 So.2d 892 (1973).

The nature of the agreement is determined by the intent of the parties. *Wagar v. Marshburn*, 241 Ala. 73, 1 So.2d 303 (1941).



To ascertain the intention of the parties, regard must be had to the relationship of the parties at the time of the contract. *G.F.A. Peanut Ass'n v. W. F. Covington Planter Co.*, 238 Ala. 562, 192 So. 502 (1939).

> "And where the parties have reduced their agreement to writing, the writing, in the absence of fraud or mistake, is the sole expositor of the transaction and the agreement of the parties. A court cannot, under the guise of construction, provide a new and different contract for the parties. . . ." (*Canal Insurance Company v. Stidham*, 281 Ala. 493, 497, 205 So.2d 516, 519 (1967))

Viewing the circumstances of this case with the above principles in mind, we must conclude that the trial court erred in construing the variable payments to have been made for services rendered.

The terminology of the agreement supports our conclusion. It is termed a "lease and license agreement." Rockaway and the Miller Company are referred to throughout as "lessor" and "lessee," respectively.

Rockaway is in the business of developing wirebound boxes and machinery to manufacture these boxes. The payments in clause 3 are unambiguous and plainly in keeping with Rockaway's business of licensing box patents and rental of machinery for manufacturing these boxes. For reference sake, the pertinent portion of the clause in question is again set forth:

> "3. Lessee agrees to pay to Lessor, in addition to the amounts hereinbefore provided to be paid by Lessee for the initial right to possess the machines leased hereunder, (a) sums of money equal to four per cent (4%) of the gross sales or fair market value, whichever is higher, of all 'Rock Fastener', 'All-Bound', and 'James' boxes made under this agreement, and (b) sums of money equal to two per cent (2%) of the gross sales or fair market value, whichever is higher, of all other boxes made under this agreement; and *Lessee agrees to pay such sums as a royalty for the use of any or all of the patented inventions hereunder licensed to be used and/or as a rental for the use of any or all machines leased hereunder;* and Lessee agrees to pay such sums . . . on or before the fifteenth day of each calendar month . . ." [Emphasis supplied.]

Under 3(a) the lessee, the Miller Company in this case, is bound to pay Rockaway 4% of the proceeds it derives from the sale of

certain named boxes: "'Rock Fastener,' 'All-Bound,' and 'James'" boxes. It is imperative to note that at the time of the agreement between the parties, the patents to those boxes were held by Rockaway. We deem it immaterial that these patents have now expired, for the Miller Company is paying Rockaway for the benefit it derives from the sales of these patented boxes. Hence, it is apparent that the 4% portion of the payment is a "royalty," as stated by clause 3 of the agreement.

The Miller Company is also obligated under 3(b) to make payments equalling 2% of the gross sales or fair market value, whichever is higher, of all boxes, other than those specifically named above, which it produces.[1]

This 2% figure is computed in one of two methods. If the box produced is one to which Rockaway retains the patent, the 2% is a "royalty" payment for the Miller Company's utilization of Rockaway's patent. However, as Rockaway's vice president testified, Rockaway also receives a 2% sum on all other boxes (those to which Rockaway does not possess the patents) which are produced on machinery leased to the Miller Company by Rockaway. Since Rockaway retains no rights in these latter boxes, payments of this second category cannot be deemed to constitute royalties paid by the Miller Company for the utilization of Rockaway's patents. It is apparent that payments of this latter category are actually proceeds paid to Rockaway for usage of the machinery. Hence, these amounts are for the lease or rental of tangible personal property.

Such a construction of the agreement is supported by the following portion of paragraph 3:

> "[A]nd Lessee agrees to pay such sums as a *royalty* for the use of any or all of the patented inventions hereunder licensed to be used and/or as a *rental* for any or all of the machines leased hereunder; . . ." [Emphasis supplied.]

---

[1] Although not set forth in the above recital of specific contract provisions, the agreement between the parties contains a paragraph which enables the Miller Company to exercise an option and thereby procure production rights to boxes patented by Rockaway subsequent to the execution of the agreement. Payments to Rockaway for this right are governed by the 2% provision of paragraph 3(b).



To the extent that the amount of the payment made by the Miller Company to Rockaway is based on the gross sales of boxes patented by Rockaway, the payments do constitute a "royalty." If in any month the Miller Company also produces boxes to which Rockaway does not hold the patents, money thus paid constitutes a "rental for the use of any or all machines leased hereunder." Thus, the rationale for the "and/or" portion of the agreement is clear. Conceivably, in any given month, the Miller Company might manufacture boxes both patented and not patented by Rockaway. In this case the "and" provision would become effective. However, if either no boxes to which Rockaway held the patent, or only boxes which it had patented were manufactured and sold by the Miller Company, the "or" provision of the clause would govern.

Similarly, other portions of the agreement reveal the trial court erred in finding the payments in question to have been made for services rendered. Nowhere in the agreement do the parties mention the alleged "services," which Kingsley testified Rockaway provided to its lessees. It is difficult for this court to reconcile the apparent intent of the parties as conveyed by the express meaning of the written words in the agreement with that which the parties would have us believe exists. Put another way, we are hard pressed to believe that parties would draft an agreement under which in excess of $3,000,000 has been paid for "services" to be rendered and not only not mention the nature of these services but actually mislabel them as constituting "royalty" and "rental" payments.

Furthermore, although Rockaway does provide the services described *supra,* we cannot at this time state that it is contractually bound to do so. As has previously been stated, Rockaway's business is two-fold. It designs and leases machinery for the production of wirebound boxes which it also designs and patents. The majority of the services it supposedly provides to the Miller Company appear to this court to be inherent in conducting a business of this nature. In other words, as opposed to being in the business of providing services to licensees of patents and lessees of machinery, Rockaway is in the licensing and leasing business. The services it performs are incidental to this primary business. We would note that Rockaway does not contend the services it provides are solely for the Miller Company. Rather, they benefit all those leasing Rockaway machinery and using Rockaway patents.

From what we have said above, it is apparent that the trial court erred in finding the payments made pursuant to paragraph 3 of

the agreement to have been for services rendered. We hold the amount of the payments made pursuant to clause 3(a) (the 4% clause) of paragraph 3 to constitute royalty payments. Likewise, receipts obtained by Rockaway pursuant to clause 3(b) (the 2% clause) are royalties insofar as the amounts thereof are based on gross receipts from the sale or production of boxes to which Rockaway retains the patents. Neither of the preceding amounts are subject to the tax imposed by Tit. 51, § 629(21), et seq:

However, the amount of the payments made by the Miller Company to Rockaway pursuant to clause 3(b) of the agreement, for the production of boxes for which Rockaway does not possess the patents, is for the lease or rental of tangible personal property. This amount, therefore, is subject to the tax imposed by Tit. 51, § 629(21), et seq.

Taxpayer additionally contends that such taxation is prohibited because the effect thereof would be taxation by the State of Alabama upon services rendered by Rockaway outside the State of Alabama. Taxpayer asserts such taxation is constitutionally impermissible because the statute fails to use an apportionment formula. This contention is without merit.

We have previously stated that the taxable portion of the payment is for the rental of tangible personal property. This property is located entirely within the State of Alabama. There is no requirement for apportionment of a tax which is levied solely on activities carried on within the state, absent a showing that such taxation places a burden on interstate commerce. *International Harvester Co. v. Department of Treasury of State of Indiana,* 322 U.S. 340, 64 S.Ct. 1019, 88 L.Ed. 1313, rehearing denied, 322 U.S. 772, 64 S.Ct. 1281, 88 L.Ed. 1597 (1944).

REVERSED AND REMANDED FOR ENTRY OF A JUDGMENT NOT INCONSISTENT WITH THIS OPINION.

WRIGHT, P. J., and BRADLEY, J., concur.

ON REHEARING

The State of Alabama, in an excellent brief in support of its application for rehearing, contends that we should withdraw our prior opinion in view of the fact that the patents on certain boxes have expired.

Able counsel for the State correctly notes that in our opinion we state, "We deem it immaterial that these patents have now expired, . . ." It is the State's position that the fact that the patents have expired is material. The revenue department cites cases which stand for the proposition that the payment of royalties beyond the expiration date of the patent constitutes misuse of the patent and is unlawful.



The appellee-Rockaway correctly points out that the cases cited by the State involve controversies between the holders of patents and their licensees and not between the parties as we have before us.

This court's opinion is in large measure bottomed on the interpretation of the contract between Miller and Rockaway. The fact that one of the parties may not have to abide by the terms of the contract does not give the State the authority to take advantage of this fact and levy a tax.

This court would further note that since the rendition of our original decree, we have discovered the case of *Stone v. Stapling Machines Co.,* 220 Miss. 470, 71 So.2d 205 (1954). This case involves the exact situation that was before us in our original opinion. Although a somewhat different conclusion was reached, the same rationale employed by this court was used by the Supreme Court of Mississippi in Sone, *supra.*

In Stone, *supra,* the Mississippi Supreme Court defined "royalty" as a tax or duty paid to the owner of the patent for the privilege of manufacturing or using the patented article. We perceive no reason why the fact that a party may not be obligated to make such payment allows the State to collect a tax pursuant to the lease tax statute.

OPINION EXTENDED; APPLICATION FOR REHEARING OVERRULED.

WRIGHT, P. J., and BRADLEY, J., concur.

**APPENDIX C**

**Ex parte STATE of Alabama.**

**SC 2591.**

**Supreme Court of Alabama.**

**June 10, 1977.**

**Certiorari to the Court of Civil Appeals, 346 So.2d 444.**

**BLOODWORTH, Justice.**

**WRIT DENIED.**

**TORBERT, C. J., and JONES, ALMON and EMBRY, JJ., concur.**

Supreme Court, U. S.
FILED
OCT 21 1977
MICHAEL RODAK, JR., CLERK

IN THE

# Supreme Court of the United States

OCTOBER TERM, 1977

No. 77-351

---

STATE OF ALABAMA,

*Petitioner,*

*vs.*

ROCKAWAY CORPORATION,

*Respondent.*

---

**On Petition for a Writ of Certiorari to the Court of Civil Appeals of the State of Alabama**

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## BRIEF IN OPPOSITION

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23 L.Ed.2d 129 (1969) ..... 5

## QUESTION PRESENTED

For purposes of applying its own lease tax statute is the State of Alabama prohibited by the Patent Act from classifying as non-taxable royalties, certain portions of payments made by a lessee after the expiration of a lessor's patent rights.

## STATEMENT OF THE CASE

This case involves an assessment by the State of Alabama under its Lease Tax law for the period July 1, 1971, through March 31, 1973, which totalled, including all penalties and interest, less than $8,000.

Rockaway Corporation (hereinafter "Rockaway") manufactures various machines which produce wire bound boxes. These machines are leased to box producers in a number of states and foreign countries. At one time Rockaway held patents for some of its box making machines, but the last of these expired during the 1950's.

Rockaway performs substantial services for each of its lessees. As the trial court noted, these services constitute a "vital and essential role" in the individual box manufacturer's sale of wire bound boxes. Included services are advertising, promotion, training of lessee's sales and service personnel, cost control, quality control, inspection at various warehouses, engineering support and new product development. Rockaway maintains a package research laboratory, and works closely with the ultimate users of wire bound boxes to develop new applications for wire bound technology. (A more complete list of the extensive services provided is found in the trial court's opinion at P. 18). In the words of the trial court:

> Based on such evidence, the Court finds that Rockaway's basic business is not that of renting machinery, but is the business of supplying services in connection with the sale of wire bound wooden boxes. [P. 18].

Rockaway is paid by box manufacturers in two ways. First, it receives fixed amounts as rent over a limited period of time for the right of the lessee to possess and use the machines. Rockaway has never contested the taxability of such fixed rentals under the Alabama Lease Tax law. Second, Rockaway receives a percentage of the lessee's proceeds of sales of boxes which are made on the machines. It is the taxability of these "variable" payments under Alabama's Lease Tax law that formed the basis of the state proceedings in this matter.

Rockaway has only one lessee in Alabama, T.R. Miller Mill Company (hereinafter "Miller"). While this business relationship dates back to 1931, the focus of the instant litigation is on a 1946 "Lease and License Agreement" which had a term of 25 years, but which was renewed for an additional 25 years by Miller in 1970. Over the years, under this Agreement Miller has paid $176,225 in fixed rentals for the various machinery it has acquired, and considerably more than that as variable payments. With respect to certain boxes, Miller's variable payment is 4% of its sales; on others, 2% of its sales. The President of Miller testified at the trial below that were it not for the extensive services provided by Rockaway, Miller would not in any way be able to make these variable payments [P. 18].

Under its Lease Tax law, Alabama imposes a tax on rental income, but not on service income or royalty income. During the course of this litigation Rockaway has maintained that the variable payments received from Miller constitute non-taxable service income. After a review



of the evidence presented, the Circuit Court agreed that all variable payments were indeed service income and therefore not taxable [P. 19].

On appeal by the State, the Court of Civil Appeals held that as a matter of Alabama law, the classification of the payments for purposes of the Alabama Lease Tax turns on the intention of the parties at the time of contracting. So viewed, the Court found that at the time of the 1946 Agreement it was the intention of the parties that all of the 4% payments and certain of the 2% payments were royalties under the lessor's then subsisting patent rights, and therefore not taxable under Alabama law. The balance of the 2% payments were found by the Court to be taxable rentals. In so ruling the Court stated:

> It is imperative to note that at the time of the agreement between the parties, the patents to those boxes were held by Rockaway. We deem it immaterial that these patents have now expired for the Miller Company is paying Rockaway for the benefit it derives from the sales of these patented boxes. [P. 28]

Dissatisfied with this result, which was clearly more favorable to the State than the trial court decision, the Alabama Attorney General moved for rehearing contending that the payment of a royalty beyond the expiration of a patent is unlawful. The Court of Civil Appeals overruled the application for a rehearing, noting again in a supplemental opinion that the taxability of the payments was based upon a construction of the contract. The Court added that the fact that one of the parties might not have to abide by the contract did not make payments under the contract taxable by the State of Alabama [P. 30]. Thereafter, the State pressed the same argument before the Alabama Supreme Court by way of *certiorari*, but the writ was denied [P. 31].

## *ARGUMENT*

**The petition should be denied because the petitioner has not presented a substantial federal question.**

The essence of the Alabama Attorney General's petition in this Court is that in applying an Alabama Lease Tax the Alabama Court erred in construing the nature of certain payments so as to render them non-taxable under Alabama law. This assertion is coupled with an astonishing request that this Court direct an Alabama court to construe the payments in question in such a way as to render them taxable.

In the Alabama proceedings the taxpayer claimed that, *for tax purposes*, the payments in question should be construed as payments for services and, therefore, totally excludable. The Alabama taxing authorities claimed that, *for tax purposes*, the payments constituted rents and, therefore, totally includable. The final determination by the Alabama Court of Civil Appeals was that the payments were originally intended to be a combination of rents and royalties and, therefore, under the Lease Tax law partially includable and partially excludable.

As even the State of Alabama we think will concede, there is absolutely nothing in the Patent Act, or in any of the cases which have interpreted it, or in any of the patent misuse cases, which requires any State to impose or to refrain from imposing a tax on royalties paid under expired patents. As authoritatively construed by the State Court, Alabama in fact does not impose such a tax. In these circumstances it is difficult to perceive a federal issue, the resolution of which could alter the decision of the Alabama Court in this case.



Petitioner relies upon *Brulotte v. Thys Co.*, 379 U.S. 29, 85 S.Ct. 176, 13 L.Ed.2d 99 (1964). There this Court (over the interesting dissent of Justice Harlan) sustained the defense of patent misuse so as to render unenforceable an agreement entered into under circumstances which clearly showed an attempt on the part of a patent holder to use leverage arising from his patent monopoly, *i.e.*, "patent power," to exact royalties beyond the period of the patent grant.[1]

Miller, the other party to the contract in the instant case, has never claimed that it was not obligated to make the variable payments in question. In fact, both parties are completely satisfied with their business relationship. The non-party attacking the agreement is the State of Alabama seeking to impose a tax. No case cited by the Petitioner involved a third person. We know of no case which would give someone not a party to a contract standing to attack it alleging patent misuse.[2]

Rockaway did not challenge below, and accepts *arguendo* here, the legal principal that any contractual obligation on Miller's part to make "royalty" payments on expired patents could be successfully resisted by Miller. However, we fail to see how, as a matter of federal law, this principal requires such payments, if made, to be

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1. There is no finding in the case at hand that Rockaway had, as an economic fact, "patent power," much less misused it. Indeed, after all patents had expired Miller voluntarily renewed the agreement. *Compare* Zenith Radio Corp. v. Hazeltine Research, Inc., 395 U.S. 100, 89 S.Ct. 1562, 23 L.Ed.2d 129 (1969).

2. In United States v. Glaro Group Ltd., 302 F.Supp. 1 (D.D.C. 1969), one District Court held that not even the Antitrust Division can sue to have patent rights declared unenforceable for misuse of patent where a defendant refuses to raise the defense of patent privilege to an antitrust complaint.

otherwise labeled so that they may be taxed by the State of Alabama.[3]

The Alabama Court did not decide this case in ignorance of federal law regarding misuse of patents. The State pressed this point on rehearing. The Court of Civil Appeals expressly found that federal law was not relevant to its construction of the Alabama taxing statute. What the State asks this Court to do is to take upon itself the interpretative powers of the Alabama Courts and broaden by independent construction the reach of the Alabama Lease Tax law. To assume such powers would be a startling departure by this Court from the principles of federalism expressed in *Erie R.R. v. Tompkins*, 304 U.S. 69, 58 S.Ct. 817, 82 L.Ed. 1188 (1938). Furthermore, to broaden this tax by construction would be to flout the Alabama policy that state taxing statutes are to be strictly construed. *State v. GM&O Land Co.*, 49 Ala.App. 707, 275 So.2d 687, *cert. den.*, 290 Ala. 371, 275 So.2d 690. If the Alabama taxing authorities believe that the Alabama Courts have too narrowly construed an Alabama statute, their recourse is to Alabama's legislature not to this Court.

3. Moreover, the Alabama Court held as a matter of state law that it was the intention of the parties *at the time of contracting* (1946, when the patent rights were in existence) which was the critical fact upon which taxability turned under the Alabama Lease Tax law; *Brulotte* was not even decided until 1964.



## CONCLUSION

The Courts of Alabama have found as a matter of state law that certain payments are not taxable under the Alabama Lease Tax. Since no federal issue is involved in such a determination, it is respectfully submitted that the Petition for a Writ of Certiorari should be denied.

Respectfully submitted,

/s/ Thomas J. Bitar
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IN THE

SUPREME COURT OF THE UNITED STATES

October Term, 1977

No. 77-351

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STATE OF ALABAMA,

Petitioner

vs.

ROCKAWAY CORPORATION,

Respondent

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On Petition for a Writ of Certiorari
to the Court of Civil Appeals
of the State of Alabama

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# PETITIONER'S REPLY BRIEF

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ROCKAWAY CORPORATION

# PETITIONER'S REPLY BRIEF

The Respondent, Rockaway, urges this Court to deny the Writ prayed for because "Petitioner has not presented a substantial federal question." But it is evident that the attempt to extend a patent beyond its statutory terms whereby the patentee or his assignee derives a benefit beyond the term set by Congress raises a very basic and essential federal question: Does the patentee have the right and the power under the patent laws of the United States as interpreted by the Supreme Court of the United States to enter into a contract during the life of a patent, and renew that contract after expiration of a patent which will have the effect of extending that patent's term beyond 17 years in a basic economic manner? The courts of Alabama in the case here involved (346 So.2d 444, Appendix B to Petitioner's original brief) have misinterpreted the federal law to hold that the patentee does have such a right and have applied this misinterpretation to the Alabama taxing statutes. The only court available to correct such a misinterpretation of federal law and policy, as expressed by Congress in the patent statutes and as interpreted by the federal courts, is this Court. Accord-

ingly, the State of Alabama has petitioned this Court to issue its writ, review the case and set forth the proper interpretation of the patent laws for the edification of the state courts and the administrators of the state tax laws.

Already, since publication of the Alabama Court of Civil Appeals opinion in this case, other taxpayers have asserted that substantial portions of their "rental receipts" derived from tangible personal property in Alabama was actually "royalty payments" based upon licenses for the use of the patents covering the device or equipment which was rented. It is clearly to be anticipated, tax accountants and attorneys being the imaginative servants of their clients that they are, that in due course a taxpayer will claim that a substantial portion of a sales tax assessment was in error because the consideration was not for the sale of tangible personal property but "royalty payments" based upon a license of a patent covering the property sold.

If, in fact, patents have an eternal life span for tax purposes, perhaps requiring only that a contract so specifying be executed within the 17 year statutory period, then what is the meaning of the words "limited times" which appear in the constitutional clause upon which the patent system is based? If this eternal life span grafted into the patent laws by the Alabama Court of Civil Appeals is proper then, sofar as a patentable device is concerned the sales tax and lease taxes of at least one state have been gutted for indeed, most equipment, such as computers, manufacturing machinery, road building equipment, in short, most modern mechanical and electrical devices and equipment are subject to at least one and often very many patents.

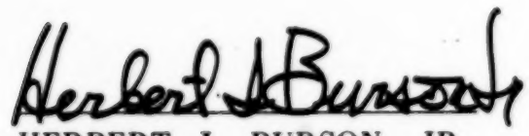


## CONCLUSION

For the reasons set forth above and in Petitioner's original brief, the Writ should be granted and this Court should inquire into the propriety of a patentee's attempt to extend by contract his patent monopoly beyond the 17 year period set by law, even if for limited tax purposes.

Respectfully submitted,

WILLIAM J. BAXLEY, Attorney General, State of Alabama



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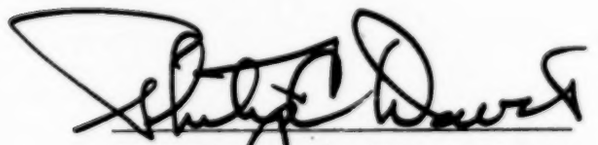

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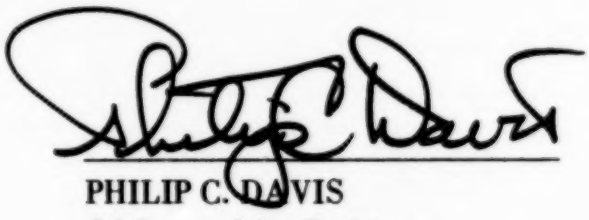
## PROOF OF SERVICE

I, Philip C. Davis, of counsel for Petitioner and a member of the Bar of the Supreme Court of the United States, certify that I have served copies of the foregoing Petitioner's Reply Brief on Honorable Oakley Melton, Jr., P. O. Box 1267, Montgomery, Alabama 36102, and Honorable Thomas J. Bitar, Dillon & Bitar, 53 Maple Avenue, Morristown, New Jersey 07960, Counsel for Respondent Rockaway Corporation, by placing same in the United States mail, postage prepaid, on November 4, 1977. All parties required to be served have been served.



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